UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re PARADIGM TECHNOLOGY, INC., Debtor.	Case No. 94-52142-MM Chapter 11
VASCONI & ASSOCIATES, Plaintiff, vs. CREDIT MANAGERS ASSOCIATION OF CALIFORNIA, et al., Defendants.	Adversary No. 96-5256
CHARLES H. SUTCLIFFE, et al., Plaintiffs, vs. CREDIT MANAGERS ASSOCIATION OF CALIFORNIA, et al., Defendants.	Adversary No. 96-5257

PREMIER TECHNICAL SALES, Plaintiff, vs. CREDIT MANAGERS ASSOCIATION OF CALIFORNIA, et al., Defendants.	Adversary No. 96-5272
IMPLANT CENTER, INC., Plaintiff, vs. CREDIT MANAGERS ASSOCIATION OF CALIFORNIA, et al., Defendants.	Adversary No. 96-5273 **MEMORANDUM DECISIONS AND ORDER DISMISSING ADVERSARY PROCEEDINGS PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 12(b)(6)**

INTRODUCTION

Before the court are the defendants' motions to dismiss under Federal Rule of Civil Procedure 12(b)(6). The plaintiffs' complaints are against individual members of the Official Committee of Unsecured Creditors for negligence and breach of fiduciary duty relating to the Committee's authorization of the allegedly premature sale of shares of the reorganized debtor's securities. For the following reasons, the motions are granted, and the complaints are dismissed.

FACTUAL BACKGROUND

The complaints for negligence and breach of fiduciary duty allege the following facts. The court confirmed the debtor's Third Amended Plan of Reorganization in June 1994. Without further notice to creditors, the Official Committee of Unsecured Creditors (the "Committee"), acting through its individual members, sold on April 28, 1995, 600,000 of 800,000 shares of Paradigm's common stock to Atmel Corporation for $4 per share, or $2,400,000. The Committee thereafter informed creditors that the shares had been sold and distributed the remaining shares to Class 9 claimants following a two-for-one reverse stock split. The reorganized debtor then proceeded with an initial public offering of its stock.

On the day of the initial public offering, the shares of Paradigm's common stock were publicly traded at $14 per share, subsequently reached a maximum price of $37.25 per share, then fell to $9 per share. The court retained jurisdiction under the plan to resolve disputes involving the interpretation of the plan.

Specifically, the confirmed plan provides that Class 9 unsecured creditors would receive cash equivalent to five percent (5%) of their allowed claim within three (3) days of the Effective Date, payments from a secured promissory note in the principal amount of twenty-five percent (25%) of all allowed unsecured claims, payable over five years at six percent (6%) interest, and a proportionate share of common stock equal to approximately eight and one-half percent (8.5%) of the capital stock of the Reorganized Debtor, which amounted to 800,000 shares. The Plan further provides that Credit Manager's Association ("CMA") would hold the cash, the secured note, and the stock **?**in trust" as the Disbursing Agent for distributions for the benefit of Class 9 claimants. The Plan grants the Committee the authority to instruct CMA as to distributions of cash and sales or distributions of stock.

The plan specifically provides:

> Should any stock in CMA's possession become liquid, the Committee may **in its discretion**, direct CMA to liquidate such stock and thereafter distribute or reserve the proceeds as is consistent with the terms of the Joint Plan. (emphasis added)

The Plan further provides that CMA would retain possession of all unsold stock until disputed claims were determined, at which time CMA would distribute any unsold stock to unsecured creditors on a pro rata basis unless a creditor elected to have CMA hold its stock until liquidated.

The Plan also contains a release provision insulating the Committee and its members from liability for actions taken in good faith to implement the plan or within the scope of § 1103(c) unless the action constitutes gross negligence or willful misconduct.

Based on these facts, the plaintiffs allege that the Committee and its members authorized CMA to sell prematurely the debtor's common stock and usurped from creditors the opportunity to determine for themselves the timing of a sale of the shares as an investment decision, and, that in doing so, the Committee breached its fiduciary duty to creditors as a trustee that disposed of trust assets without notice to beneficiaries. They contend that prior to the sale, the Committee should have notified creditors of its intention, sought court authority to sell the shares held by CMA, obtained an appraisal of the value of the shares, sought a fairness opinion, and solicited competing bids because there was no public market

for the shares.

Each of the plaintiffs or the corporate entity either voted to accept the plan or declined to submit a ballot. At the time the Committee disbursed to creditors the proceeds of the sale of stock, unsecured creditors had been repaid 75% of their allowed unsecured claims in cash and from the proceeds of the secured note. Upon disbursement of a proportionate share of the unsold stock, there was the prospect that unsecured creditors would be repaid 100% of their claims after they liquidated their stock. Plaintiffs have now been paid well in excess of 100% of their allowed unsecured claims. The Committee contends that unsecured creditors have received approximately one-hundred thirty percent (130%) of their allowed claims.

DISCUSSION

A. Standard for Dismissal Under Federal Rule of Civil Procedure 12(b)(6)

For a defendant to prevail on a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), it must appear beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. Conley v. Gibson, 355 U.S. 41, 45-46 (1957); Cervantes v. City of San Diego, 5 F.3d 1273, 1274 (9th Cir. 1993). The purpose of a motion under Federal Rule 12(b)(6) is to test the formal sufficiency of the statement of the claim for relief in the complaint. Rutman Wine Co. v. E. & J. Gallo Winery, 829 F.2d 729, 738 (9th Cir. 1987). It is not a procedure for resolving a contest about the facts or the merits of the case. In reviewing the sufficiency of the complaint, the issue is not whether the plaintiff will ultimately prevail but whether the plaintiff is entitled to offer evidence to support the claims asserted. Scheuer v. Rhodes, 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974). Since the motion raises only an issue of law, the court has no discretion as to whether to dismiss a complaint that it determines to be formally insufficient. Yuba Consolidated Gold Fields v. Kilkeary, 206 F.2d 884, 889 (9th Cir. 1953).

In determining whether to grant a motion to dismiss under Federal Rule 12(b)(6), the court primarily considers the allegations in the complaint, matters of public record, orders, items appearing in the record of the case, and exhibits attached to the complaint. Hal Roach Studios v. Richard Feiner & Co., 896 F.2d 1542, 1555 n. 19 (9th Cir. 1990); Emrich v. Touche Ross & Co., 846 F.2d 1190, 1198

(9th Cir. 1987); Mack v. South Bay Beer Distributors, Inc., 798 F.2d 1279, 1282 (9th Cir. 1986). See also 5A Wright & Miller, *Federal Practice and Procedure* § 1357 (West 1990). The complaint should be construed in the light most favorable to the plaintiff, and its allegations are taken as true. Scheuer, 416 U.S. at 237. A defendant may assert an affirmative defense of a qualified immunity in a Rule 12(b)(6) motion. Vaughn v. U.S. Small Business Adminsitration, 65 F.3d 1322, 1325 (6th Cir. 1995); Sveeggen v. U.S., 988 F.2d 829, 831 (8th Cir. 1993). Dismissal is appropriate where the complaint itself establishes the circumstances necessary as a predicate to a finding of qualified immunity. Weaver v. Clarke, 45 F.3d 1253, 1255 (8th Cir. 1995); Fortner v. Thomas, 983 F.2d 1024, 1028 (11th Cir. 1993); Green v. Maraio, 722 F.2d 1013, 1019 (2d Cir. 1983). The same is also true where the complaint fails to allege any facts that would cast doubt on or invite inquiry as the scope of an immunity based on the defendant's alleged malice or bad faith. Franklin v. Zuber, 56 F.R.D. 601, 604 (S.D.N.Y. 1972).

B. Scope of Immunity of Committee

The Bankruptcy Code contemplates a significant and central role for creditors' committees in the scheme of a business reorganization. In re Penn-Dixie Indus., Inc. 9 B.R. 941, 944 (S.D.N.Y. 1981). Section 1103(c) provides that a creditors' committee "may . . . (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formualtion of a plan; (3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan; . . . and (5) perform such services as are in the best interest of those represented." This broad scope of authority implies both a fiduciary duty to committee constituents and a grant of limited immunity to committee members. In re L.F. Rothschild Holdings, 163 B.R. 45, 49 (S.D.N.Y. 1994). The purpose of the immunity is to assure the effective representation of the committee's constituency and to further the committee's statutory duties and powers. Pan Am Corp. v. Delta Air Lines, Inc., 175 B.R. 438, 515 (S.D.N.Y. 1994). However, such immunity is limited only to actions taken within the scope of the committee's authority as conferred by statute or the court and may not extend to willful misconduct of the committee or its members. L.F. Rothschild, 163 B.R. at 49. The

willful misconduct standard strikes the proper balance between breach of duty and limited immunity. In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717, 718-22 (Bankr. S.D.N.Y. 1992), aff'd, 140 B.R. 347 (S.D.N.Y. 1992). See, e.g., In re General Homes Corp., 181 B.R. 870, 882 (Bankr. S.D. Tex. 1994)(limited immunity does not extend to knowing violation of stay). Generally, a committee may not have immunity for actions beyond the scope of authority conferred by statute or the court. Luedke v. Delta Air Lines, Inc., 159 B.R. 385, 392 (S.D.N.Y. 1993). Willful misconduct or *ultra vires* acts may remove the action of committee members from the scope of the qualified immunity. Id. at 392. "Willful conduct" requires a showing of either the intentional performance of an act with knowledge that the performance of that act will probably result in injury or the intentional performance of an act in such a manner as to imply reckless disregard of the probable consequences. Pan Am Corp. v. Delta Air Lines, 175 B.R. at 514 n. 66. *Ultra vires* acts require a showing that the conduct was engaged in without any authority whatever. Id.

Viewing the facts set forth and referred to in the complaint and all reasonable inferences to be drawn from those facts, the complaint fails to state a claim for which relief may be granted. The qualified immunity extends to the Committee's actions in this case because those actions were expressly authorized by the confirmed plan and were taken in furtherance of plan implementation under § 1103, so the actions were not *ultra vires.* The Plan expressly grants the Committee discretion to sell the stock in CMA's possession should the stock become "liquid," which unambiguously refers to the ability to convert readily into cash. The court considered the Plan in view of the requirements of § 1129 and approved confirmation of the plan.

Furthermore, the plaintiffs' argument that the reverse stock split and sale of shares was a substantial change to the Third Amended Plan that required notice to creditors under § 1127 is misplaced. The Class 9 unsecured creditors received distributions precisesly as provided for under the Plan: cash and a pro rata share of 8.5% of the reorganized debtor's stock, subject to split and expressly subject to sale and conversion into cash.

The plaintiffs have also failed to plead any facts that suggest or give rise to the inference that the Committee's actions constitute either willful misconduct or gross negligence. The authorization for the sale of the debtor's securities appear to be a reasonable exercise of business judgment in view of the

speculative nature of the sale of securities. The court concludes that the Committee's action is within the scope of the qualified immunity granted to committee members.

C. The Plan Releases the Committee From Liability

A confirmed plan may provide for the release of committee members from liability in their capacity as a member of the committee. L.F. Rothschild, 163 B.R. at 49. This is particularly true where the release provision, like the one in this case, preserves liability of the committee and its members for willful misconduct. Drexel, 138 B.R. at 722. The confirmed plan includes an express provision releasing the Committee from liability for authorized acts taken in good faith. The court retained jurisdiction under the plan to interpret and to enforce its provisions. Creditors are bound to its treatment under the confirmed plan, which has a binding effect like that of a final judgment, whether or not the creditor voted to accept the plan. Stoll v. Gottlieb, 305 U.S. 165, 170-71, 59 S.Ct. 134, 137, 83 L.Ed. 104 (1938); In re Heritage Hotel Partnership I, 160 B.R. 374, 377 (Bankr. 9th Cir. 1993); 11 U.S.C. § 1141(a). Thus, the plaintiffs are bound by the plan's release provision.

D. The Plan Did Not Create An Express Trust Under California Law

The plaintiffs have argued that the Committee members breached their fiduciary duties by disposing of trust assets. Under California law, the creation of an express trust requires the following elements: a competent trustor, an intention on the part of the trustor to create a trust, a trustee, an estate conveyed to the trustee, and acceptance of the trust by the trustee, a beneficiary, a legal purpose, and a legal term. In re Golden Triangle Capital, Inc., 171 B.R. 79, 82-83 (Bankr. 9th Cir. 1994); Reagh v. Kelley, 10 Cal. App. 3d 1082, 1089, 89 Cal. Rptr. 425 (1970). Use of the words **?**in trust" does not conclusively establish the existence of a trust. Golden Triangle Capital, 171 B.R. at 83; Petherbridge v. Prudential Savings & Loan Ass'n, 79 Cal. App. 3d 509, 519, 145 Cal. Rptr. 87 (1978). There is no indication in the plan that designating CMA as Disbursing Agent was intended to create an express trust.

A committee is a fiduciary to its constituent class members. Pan Am Corp., 175 B.R. at 514. However, a fiduciary acting in its official capacity is distinguishable from the trustee of an express trust. See, cf., In re Johnson, 518 F.2d 246, 251 n.5 (10th Cir. 1975), cert. denied, 423 U.S. 893, 96 S.Ct. 191,

46 L.Ed.2d 125 (1975)(by acting in his official capacity the trustee does not incur a personal liability as does the trustee of an express trust). Historically, a bankruptcy estate fell within the classic definition of a trust because the trustee held property of the estate in trust for the benefit of creditors who are the beneficiaries of the trust. Clark v. Clark, 58 U.S. 315, 321 (1854). Under common law, there are limited circumstances in which the usual prohibitions to a fiduciary's authority to deal with estate property do not apply. These limited circumstances include where the transaction is authorized by the trust instrument. Alternatively, the fiduciary may give full notice of the transaction to interested parties and obtain court approval. Mosser v. Darrow, 341 U.S. 267, 274, 71 S.Ct. 680, 683, 95 L.Ed. 927 (1951).

Beyond the common law trust duties, the duties of a fiduciary to the bankruptcy estate are superimposed upon and further defined by statutory duties. In re Markos Gurnee Partnership, 182 B.R. 211, 219 (Bankr. N.D. Ill. 1995)(§ 704); § 1103. Specifically, § 1103, grants a creditors' committee broad authority to participate in the formulation of a plan and to perform such services as are in the best interest of the committee's constituents. Moreover, the plan, like an enabling trust instrument, both authorizes the Commitee to exercise its discretion in conducting a sale of the stock and provides immunity to the Committee for actions taken in good faith.

The plaintiffs' reliance solely on California trust law is not wholly apposite because the plan did not create an express trust under California law. Instead, the duties of a creditors' committee arising from common law must be viewed in conjunction with the fiduciary duties imposed on the committee by statute and court order. In considering the Committee's powers granted under § 1103, the Committee authorized the sale of the stock in furtherance of implementation of the plan, and its action was expressly authorized. Further, the Committee provided full disclosure and obtained court approval of the sale of shares of the reorganized debtor's securities through the confirmation process, so the Committee's actions satisfy the standard for fiduciary conduct set forth in Mosser v. Darrow.

CONCLUSION

The motions are granted because the plan expressly authorizes the Committee's actions, expressly releases the committee members from liability, and failed to create an express trust. A qualified immunity

applies to insulate the Committee from liability since the complaint does not give rise to an inference of willful misconduct or gross negligence. The Committee's actions were also consistent with the Committee's duties under § 1103. This decision obviates the need for the court to address the Committee's motion in the alternative for summary judgment.